

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 AGR-20 CEA-02 CIAE-00 COME-00 DODE-00

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NSC-07 PA-04 RSC-01 AID-20 CIEP-02 SS-20 STR-08

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INFO AMCONSUL RIO DE JANEIRO

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E.O.11652: N/A

TAGS: EFIN, BR

SUBJECT: GENERAL ECONOMIC SITUATION AND GOVERNMENT'S POLICY

1. SUMMARY: IN MEETING WITH TREASURY REP, ECONOMIC ADVISOR TO MINISTER CHIEF OF PLANNING SECRETARIAT OF PRESIDENCY MADE FOLLOWING POINTS ON NEW GOVERNMENT'S ECONOMIC POLICIES AND GENERAL ECONOMIC SITUATION: (A) NOTED THAT GOVERNMENT ATTEMPTING TO GIVE ECONOMY NEW DIRECTION, (B) STRESSED SERIOUSNESS OF INFLATIONARY SITUATION, (C) EMPHASIZED THAT MONETARY AUTHORITIES WILL APPLY MONETARY BRAKES TO FIGHT INFLATION AND WILL ACCEPT SOME COOLING OFF IN SOME SECTORS SUCH AS THE CAR INDUSTRY, (D) STATED THAT GOVERNMENT WANTS TO SEE SOME TIGHTENING OF CONSUMER CREDIT, AND (E) THAT GROWTH RATE THIS YEAR EXPECTED TO BE IN LINE WITH THAT OF PAST YEARS. WE BELIEVE NEW GOVERNMENT IS PREPARED TO PLAY MORE ACTIVE ROLE IN ECONOMY BUT THERE IS NO EVIDENCE TO DATE TO INDICATE SIGNIFICANT DEPARTURE FROM GOALS OF PREVIOUS ADMINISTRATIONS. IT IS EVIDENT THAT UNLIKE PREVIOUS GOVERNMENT, THIS ADMINISTRATION

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WILL RELY MORE HEAVILY ON MONETARY POLICY TO CONTROL INFLATION. END SUMMARY

2. IN A MEETING WITH TREASURY REP, LUIZ VICTOR MAGALHAES, ECONOMIC ADVISOR TO REIS VELLOSO, MINISTER CHIEF OF PLANNING SECRETARIAT OF PRESIDENCY, GAVE TOUR D'HORIZON OF ECONOMIC SITUATION AND INDICATED DIRECTION OF ECONOMIC POLICY OF NEW GOVERNMENT. FOLLOWING IS A SUMMARY OF MAJOR POINTS MADE BY MAGALHAES:

A. THE PRINCIPAL OBJECTIVE OF NEW GOVERNMENT'S ECONOMIC POLICY IS TO GIVE ECONOMY NEW DIRECTION. GREATER EMPHASIS WILL BE GIVEN TO CAPITAL GOODS INDUSTRY (IN ORDER TO DECREASE RELIANCE ON IMPORTS OF THESE ITEMS), RAW MATERIALS (OIL AND FERTILIZERS IN PARTICULAR) AND AGRICULTURE. HE SAID GOVERNMENT WILL PARTICIPATE MORE ACTIVELY THAN IN THE PAST TO ASSURE THE ECONOMY STEERS IN THE DESIRED DIRECTION. IT WAS WITH THIS GOAL IN MIND THAT ECONOMIC DEVELOPMENT COUNCIL SET UP THE THREE SPECIAL AGENCIES ATTACHED TO BNDE (SEE BRASILIA 3748). HE STRESSED THAT THE GOVERNMENT'S GOAL WAS NOT RPT NOT TO INCREASE ITS DIRECT INVOLVEMENT IN PRODUCTIVE ACTIVITY BUT TO ASSIST THE PRIVATE SECTOR, ESPECIALLY SMALLER FIRMS, IMPROVE ITS COMPETITIVE POSITION VIS-A-VIS THE PUBLIC SECTOR AND THE MULTINATIONALS.

B. THIS GOVERNMENT INHERITED A SERIOUS INFLATIONARY SITUATION WHEN IT TOOK OFFICE ON MARCH 15, WHICH FORCED IT TO TAKE TRADITIONAL RESTRICTIVE MEASURES EARLIER THAN WOULD OTHERWISE HAVE BEEN DESIRABLE. FOR THE LAST FEW YEARS BRAZILIAN MONETARY AUTHORITIES (HE DID NOT MENTION DELFIM NETTO SPECIFICALLY) HAD RELIED ON PRICE CONTROLS AND INCREASED INPUT OF AGRICULTURAL PRODUCTS TO CONTAIN INFLATION WHILE MONETARY POLICY PLAYED A SECONDARY ROLE. THIS SYSTEM WORKED RELATIVELY WELL UNTIL LATTER HALF OF 1973 WHEN THE OLD GOVERNMENT ADOPTED A POLICY OF REPRESSING INFLATIONARY PRESSURES EMANATING FROM WORLD-WIDE INFLATION AND SHORTAGE OF AGRICULTURAL COMMODITIES FOR DOMESTIC CONSUMPTION. UPON TAKING OFFICE, NEW GOVERNMENT DECIDED TO FOLLOW A MORE REALISTIC PRICE POLICY AND, IN ORDER TO PREVENT A RUNAWAY INFLATION, TO APPLY TRADITIONAL MONETARY BRAKES (I.E., IT SET ON EXPANSION OF MONEY SUPPLY IN 1974 TO 35 PERCENT AS OPPOSED TO 47 PERCENT 1973). HE CONFIRMED THAT SYSTEM OF MONETARY CORRECTION PROVIDES CERTAIN AMOUNT OF SELF-GENERATION TO LIMITED OFFICIAL USE
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INFLATIONARY PRESSURES AND GOVERNMENT IS VERY ANXIOUS TO SEE DOWNWARD TREND IN INFLATION RATE, AFTER THE PRICE ADJUSTMENTS OF FIRST QUARTER. HE SAID GOVERNMENT HOPES TO HAVE INFLATION ON A DOWNWARD TREND IN SECOND HALF OF YEAR.

C. HE CONTINUED BY SAYING THAT INFLATION CONTROL IN BRAZIL IS ESPECIALLY DIFFICULT AT THIS TIME SINCE PRESSURES ARE BEING EXERTED ON BOTH DEMAND AND SUPPLY SIDES. HE NOTED THAT THE GOVERNMENT WAS PARTICULARLY DETERMINED TO WIPE OUT EXCESS DEMAND, ALTHOUGH IT WOULD WORK ON THE SUPPLY AS

WELL. IN ATTEMPTING TO ELIMINATE EXCESS DEMAND, THE GOVERNMENT IS TRYING TO CUT BACK CONSUMER SPENDING AND THIS WAS THE OBJECTIVE OF THE RECENT CENTRAL BANK MEASURES WHICH IN EFFECT LIMITED THE MATURITY OF LETRAS DE CAMBIO TO 24 MONTHS. (SEE BRASILIA 3419.) WHEN ASKED WHETHER THERE WAS ANY DANGER THAT THESE MEASURES MAY CUT INTO DEMAND MORE THAN IS DESIRABLE, HE REPLIED IN THE NEGATIVE. HE POINTED OUT THAT HERETOFORE AUTHORITIES HAD BEEN TOO LIBERAL IN GRANTING CONSUMER CREDIT AND THIS WAS IN PART RESPONSIBLE FOR RECENT INFLATION. LIBERAL CREDIT POLICY LED TO HIGHER RETAIL PRICES (BRAZILIAN RETAIL STORES USUALLY QUOTE PRICES BY MONTHLY PAYMENTS) AND BROUGHT INTO THE MARKET FOR PURCHASE OF DURABLE GOODS BUYERS FROM LOWER INCOME GROUPS WHO IN THE ABSENCE OF ABUNDANT CREDIT WOULD NORMALLY NOT BE ABLE TO AFFORD THESE GOODS. WHILE EASY CONSUMER CREDIT NO DOUBT HELPED BRAZIL'S ECONOMIC BOOM, THE GOVERNMENT HAS DECIDEDN, HE SAID, THAT TIME HAS COME WHEN IT WOULD BE HEALTHY TO REDUCE CONSUMER CREDIT IN THE FIGHT AGAINST INFLATION.

D. MAGALHAES WAS ASKED WHETHER THE CAR INDUSTRY WAS NOT IN FACT ALREADY SUFFERING FROM THE GOVERNMENT'S ANTI-INFLATIONARY PROGRAM (SEE SAO PAULO 1132). HE REPLIED THAT THE GOVERNMENTN WANTED TO COOL OFF THE CAR INDUSTRY TO FIGHT INFLATION. TO THE EXTENT THAT CAR MANUFACTURERS WERE ENCOUNTERING PROBLEMS THESE WERE ATTRIBUTABLE TO HIGHER GASOLINE PRICES AS MUCH AS ANYTHING ELSE. HE ATTRIBUTED THE CLOSING DOWN OF FORD'S MAVERICK PRODUCTION PLANT, FOR EXAMPLE, TO HIGHER GASOLINE PRICES AND SHORTAGE OF SPARE PARTS, AND NOT TO SCARCITY OF CREDIT. HE NOTED THAT FORD STOPPED IMPORTING V-8 ENGINES FOR THE MAVERICK SOME MONTHS BEFORE THE CREDIT SQUEEZE WENT INTO EFFECT; BECAUSE OF THE HIGH PRICE OF GASOLINE,
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CUSTOMERS DID NOT WISH TO PURCHASE CARS WITH BIG ENGINES. OVERALL, HE WAS OPTIMISTIC ABOUT GROWTH OF CAR INDUSTRY AND ECONOMY IN GENERAL DURING 1974. HE SAID GOVERNMENT IS EXPECTING EVERALL GROWTH RATE THIS YAR TO BE INLINE WITH THAT EXPERIENCED IN RECENT YEARS (I.E., ABOUT 10 PERCENT).

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3. AS A SIDE COMMENT, MAGALHAES SAID THAT NUMEROUS INDUSTRIALISTS HAD BEEN COMPLAINING TO GOVERNMENT OFFICIALS IN RECENT WEEKS ABOUT POSSIBLE ADVERSE CONSEQUENCES OF ANTI-INFLATION PROGRAM. HE NOTED THAT PART OF THE REASON FOR THESE PEOPLE'S CONCERN AROSE FROM THE FACT THAT THEY HAD BECOME ACCUSTOMED TO DOING BUSINESS IN AN ENVIRONMENT OF ABUNDANT LIQUIDITY, AND NOW THAT CREDIT IS NOT AS READILY AVAILABLE THEY ARE HAVING ADJUSTMENT PROBLEMS. HE SAID GOVERNMENT IS MAKING AN ALL-OUT EFFORT IN EXPLAINING ITS PROGRAM TO INDUSTRY AND THAT ONCE A BETTER UNDERSTANDING IS ACHIEVED INDUSTRY WILL FIND THAT IT CAN LIVE WITH MEASURES WITHOUT GREAT DIFFICULTY.

4. COMMENT: MAGALHAES IS ONE OF THE VERY CLOSE ADVISORS TO MINISTER REIS VELLOSO. HE WORKED FOR THE IMF IN WASHINGTON FOR A NUMBER OF YEARS, APPEARS TO BE COMPETENT AND SEEMS TO HAVE CONSIDERABLE INFLUENCE WITH THE MINISTER.

5. MAGALHAES' COMMENTS ARE INTERESTING IN THAT THEY PROVIDE AN INSIDER'S VIEW OF GOVERNMENT'S ECONOMIC POLICIES. TO
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SOME EXTENT, HOWEVER, HIS REMARKS WERE SELF-SERVING, ESPECIALLY WITH REGARD TO GIVING ECONOMY NEW DIRECTION. GOVERNMENT OFFICIALS HAVE REPEATEDLY RETURNED TO THIS THEME, BUT DEPARTURES FROM BASIC GOALS OR POLICIES OF OTHER POST-REVOLUTION GOVERNMENTS HAVE SO FAR BEEN MODEST.

6. IT IS CLEAR THAT THIS GOVERNMENT IS DETERMINED TO MAINTAIN A TIGHTER CREDIT SITUATION THAN ITS PREDECESSOR. WHILE IT IS

TOO EARLY TO MAKE A JUDGMENT AS TO HOW FAR THE GOVERNMENT
WILL GO DOWN THIS PATH IN CONTROLLING INFLATION, WE SUSPECT
IT WILL NOT GO BEYOND THE POINT OF INCREASING UNEMPLOYMENT AND
SLOWING DOWN THE GROWTH RATE, EXCEPT IF BALANCE OF PAYMENTS
CONSTRAINTS REQUIRE IT. IN IMPLEMENTING TIGHTER CREDIT POLICY,
THIS GOVERNMENT APPEARS TO HAVE TWO OBJECTIVES IN MIND: (A)
IT FEELS IT CAN FINE-TUNE THE ECONOMY BETWEEN INFLATION
CONTROL AND RAPID ECONOMIC GROWTH, AND (B) IT IS TRYING TO
PERMIT FASTER GROWTH OF HIGHER PRIORITY INDUSTRIES (SUCH AS
THE CAPITAL GOODS INDUSTRY) WHILE COOLINGOFF OTHER SECTORS
(SUCH AS AUTOMOBILES).
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